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Partial VAT recovery for costs related to hire purchase agreements

On October 18, 2018, the Court of Justice of the European Union ('CJEU') delivered its judgment in the Volkswagen Financial Services (UK) Limited case (C-153/17). The CJEU ruled that in the case of a hire purchase agreement, the supply of a vehicle and supplies of credit can be treated as separate supplies for VAT purposes. Even though no profit is being made by VWFS with the supply of vehicles, the VAT recovery method of VWFS should take account of an actual and non-negligible allocation of general costs to transactions giving rise to a right to recover input VAT.

Background

The taxpayer ('VWFS') offers customers a hire purchase agreement. The hire purchase agreement is broken down by VWFS into 1) the supply of a car and 2) the provision of a loan. The supply of the car is treated as taxable. The price for the supply of the car equals the price that VWFS pays to a dealer in order to buy the car. The provision of the loan is treated as exempt. VWFS's profits are derived from the provision of loans. In dispute is whether VWFS should be allowed to recover input VAT on general costs.

CJEU judgment

The CJEU firstly commented on whether the various transactions relating to hire purchase supplies must be treated as distinct transactions for VAT purposes, which are taxable separately or as a single complex transaction composed of several elements. The CJEU followed the referring UK court's view that each car hire purchase agreement consists of several separate supplies, namely, on the one hand, the supply of a vehicle, and, on the other, supplies of credit. The CJEU then ruled that the supply of credit is VAT exempt, provided that the payment of interest does not constitute part of the consideration obtained for the supply of goods or services, but is only a consideration for the granting of that credit. In reaching this conclusion, the CJEU recognized that deferred payment of the purchase price of goods can be treated as the provision of a VAT-exempt loan.

With regard to the recovery entitlement for VAT on overhead costs, the CJEU ruled that even though VWFS decided to only include the overhead costs in the price of the exempt transactions and not in the price of the taxable transactions, the general costs at issue have a direct and immediate link with the activities of VWFS as a whole, and not merely with the loans. Accordingly, the VAT on these general costs should be partially recoverable.

As a general rule, the VAT recovery entitlement for overhead costs must be determined by reference to turnover. However, Member States may apply a method or allocation key other than the turnover-based method, on condition that the method used guarantees a more precise determination of the deductible proportion of the input VAT. The UK tax authorities argued that the turnover generated by the sale of the vehicles should not be taken into account when calculating the recovery rate for VWFS. The CJEU however ruled that a method that does not take account of the value of the vehicles is not permissible, since that method does not ensure a more precise apportionment than that which would arise from the application of the turnover-based allocation key. The CJEU ruled that an alternative method should take account of an

actual and non-negligible allocation of general costs to transactions giving rise to a VAT recovery right.

Initial comments and practical consequences

The CJEU's decision is not in line with the AG's Opinion. The AG found that a hire-purchase agreement qualifies as a single taxable supply. In our earlier news update we commented that we doubted whether the CJEU would follow this conclusion. The decision that the CJEU has now reached on the qualification of VWFS' supplies appears to be in line with Dutch VAT practice. Like the UK position, hire purchase arrangements and certain financial leases can, under certain conditions, be separated into a taxable supply of goods and the VAT-exempt provision of a loan.

The CJEU's judgment in the VWFS case does appear to provide an opening for taxpayers that have been confronted with input VAT recovery restrictions following the judgment in Banco Mais (case C-183/13). The CJEU seems to nuance the latter judgment. Banco Mais carried on leasing activities in the automotive sector. It received both interest income and rental income. Like VWFS, Banco Mais did not charge a margin on the car-related income. In this case, the CJEU ruled that for the calculation of the VAT recovery entitlement on overhead costs, the rental payments made by customers should not be taken into account if the use of the overhead costs are primarily caused by the (VAT-exempt) financing and management of those contracts. The CJEU has now ruled that the Banco Mais judgment does not provide a general principle that applies to all similar types of transactions in the automotive industry. For those operating in the leasing industry it might be worth exploring the possibility of improving the input VAT recovery method.

The tax advisors of Meijburg & Co's Indirect Tax Financial Services Group would be pleased to help you identify the potential implications of this judgment. Please feel free to contact one of them or your regular contact at Meijburg & Co.

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October 2018